No. 85-1805

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

October Term, 1985

ALEXANDER ROSS, JAMES L. MELCHER, IVAN BLOCH, VINCENT GIOVINCO, BRUCE MALE, FREDERICK M. MYERS, JOHN C. FITCH, and LEWIS W. SIEGAL, individually and as representative of all others similarly situated,

*Petitioners,*

*vs.*

AFP IMAGING CORPORATION,

*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## BRIEF IN OPPOSITION

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## Counterstatement of the Question Presented

Given that the non-arbitrability of claims alleging violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et. seq.*, has been long-established federal policy, and given that section 27 of the Act provides for exclusive jurisdiction in the federal courts of claims under the Act and that section 29(a) of the Act voids any contract, stipulation or provision waiving any provision of the Act, may a purchaser of securities be compelled to arbitrate a section 10(b) securities fraud claim against his sellers pursuant to a pre-dispute arbitration clause in the allegedly fraudulent contract for the sale of securities?

## List of all Parties

See Memorandum For The Petitioners at ii. The list of respondent's affiliated corporations is as follows: AFP/Matrix Imaging (UK) Ltd.; AFP/Kenro; CES Imaging Products, Inc.; Instrumentation Camera Inc.; Pako Corporation; Tudorcape Inc.; Kenro Corporation; and Photo Guard Associates.

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## BRIEF IN OPPOSITION

### Opinions Below

See Memorandum For The Petitioners at 1, and A-1 to A-24.

### Jurisdiction

See Memorandum For The Petitioners at 2.

## Statutes Involved

See Memorandum For The Petitioners at 2-3, and A-38 to A-42, and the appendix hereto at A-1—A-2.

## Counterstatement of the Case

Petitioners sold all of the capital stock of Xenon Industries, Inc. to respondent, AFP Imaging Corporation. The written contract of sale, dated August 8, 1984, was nominally between Xenon and AFP; however, Xenon acted as petitioners' agent, pursuant to express written authority, to "cause the sale" of petitioners' stock to AFP.

In order to induce AFP to acquire their Xenon shares, petitioners made several false representations to AFP in the contract of sale concerning Xenon's financial condition. Petitioners represented, *inter alia,* that Xenon's financial statements were accurate. After the closing of the sale, AFP learned that those representations were false, and by reason of petitioners' fraud has suffered losses of at least $900,000. AFP commenced an action in the United States District Court for the Southern District of New York alleging that petitioners' knowing misrepresentation of Xenon's financial condition was a violation of section 10(b) of the Securities Exchange Act of 1934[1] and Rule 10b-5 of

1. The Securities Exchange Act of 1934 will be referred to as the 1934 Act. The Securities Act of 1933 will be referred to as the 1933 Act. References to sections 10(b); 27; and 29(a) of the 1934 Act are references to, respectively: 15 U.S.C. § 78j(b) (section 10(b)); 15 U.S.C. § 78aa (section 27); 15 U.S.C. § 78cc(a) (section 29(a)). References to sections 12; 14; and 22 of the 1933 Act are references to, respectively: 15 U.S.C. § 771 (section 12); 15 U.S.C. § 77n (section 14); 15 U.S.C. § 77v (section 22). Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, is referred to as Rule 10b-5. The text of these provisions of the 1934 Act and the provisions of the United States Arbitration Act, 9 U.S.C. §§ 2 and 3, are set forth in the appendix of Memorandum for Petitioners at A-38 to A-42. Relevant provisions of the 1933 Act are set forth in the appendix attached hereto at A-1 to A-2.

the Securities and Exchange Commission and that those misrepresentations constituted common law fraud.

After the action was commenced, petitioners attempted to preclude respondent's efforts to obtain judicial relief by moving to compel arbitration of AFP's claims pursuant to an arbitration clause in the contract of sale. Petitioners also moved to dismiss the action pursuant to Rule 9(b) of the Federal Rules of Civil Procedure and subsequently converted their motion to dismiss to a motion for summary judgment.

On May 2, 1985, the District Court (Brieant, J.) granted petitioners summary judgment as to AFP's section 10(b) securities fraud claim and granted petitioners' motion to compel arbitration of AFP's state law claim. It did not reach the question of the arbitrability of AFP's section 10(b) claim.

AFP appealed to the United States Court of Appeals for the Second Circuit. On Appeal, petitioners attempted to defend the District Court's grant of summary judgment. Consequently, in the Second Circuit neither party briefed or argued the question petitioners present here concerning the arbitrability of a section 10(b) claim.

On December 23, 1985, the Second Circuit reversed the summary judgment dismissing AFP's section 10(b) claim. *AFP Imaging Corp.* v. *Ross,* 780 F.2d 202 (2d Cir. 1985).

The Second Circuit, after reversing summary judgment, remanded the securities fraud claim to the District Court. In remanding this claim it stated that, pursuant to the long standing rule in the Second Circuit, the arbitration pro-

vision in the contract of sale was "of course, unenforceable." *Id.* at 205. Petitioners sought to raise the question of the arbitrability of the section 10(b) claim for the first time in the Second Circuit in their petition for rehearing and suggestion for rehearing *en banc*. The Second Circuit denied the petition on February 3, 1986.[2] Petitioners now seek *certiorari* to have this Court review the long-standing federal policy that section 10(b) claims are not arbitrable, an issue the District Court did not decide, which petitioners did not argue or brief in the Second Circuit, and which they raised for the first time in that Court in their petition for rehearing.[3]

## Certiorari Should Be Denied

The unenforceability of a pre-dispute arbitration agreement with respect to claims under section 10(b) of the 1934 Act has been the long established rule in every circuit which has considered the question. (See cases cited *infra* at 9, n.4). The rule is soundly grounded in federal policy and in *Wilko* v. *Swan*, 346 U.S. 427 (1953), in which this Court held that claims under section 12(2) of the 1933 Act are not arbitrable. In *Dean Witter Reynolds, Inc.* v. *Byrd*, —— U.S. ——, 105 S.Ct. 1238, 1240, n.1 (1985), this Court recently noted in *dictum* that it had previously questioned the application of *Wilko* by the lower federal courts to 1934 Act claims, but also that the applicability of *Wilko* to such

2. AFP represented to the Court of Appeals that it would withdraw its common law fraud claim on remand, mooting the issue of the arbitrability of that claim. *AFP Imaging Corp.* v. *Ross, supra* at 205. The claim was subsequently withdrawn. *AFP Imaging Corp.* v. *Ross*, No. 85 Civ. 1149-CLB (S.D.N.Y. 1986).

3. Respondent was served with the present Petition on May 2, 1986.

claims "has retained considerable vitality in the lower federal courts." *Id.* In this case, commenced before *Byrd* and arising out of a transaction which had taken place long before *Byrd*, the Second Circuit restated the long-standing rule that pre-dispute agreements to arbitrate section 10(b) claims are "of course, unenforceable." *AFP Imaging Corp.* v. *Ross, supra* at 205. Even more recently, in *McMahon* v. *Shearson/American Express, Inc.*, Dkt. Nos. 85/7844, 85/7846 slip op. (2d Cir. April 16, 1986) the Second Circuit reiterated the rule.

The Court should deny *certiorari* because:

1. This case is not an appropriate vehicle for review of the long-established federal policy that section 10(b) claims are not arbitrable.

2. There is no conflict in the circuits as to the long-standing federal policy that section 10(b) claims are not arbitrable;

3. The Second Circuit rule is not in conflict with any decision of this Court; and

4. The decision below is correct.

### A. This Is Not An Appropriate Vehicle For This Court to Review The Established Federal Policy Of The Nonarbitrability Of Section 10(b) Claims

#### 1. The District Court Did Not Decide The Question Presented And Petitioners Did Not Raise It In the Second Circuit

The issue presented by the petitioners was neither briefed nor argued in the Second Circuit. The District Court had granted summary judgment dismissing AFP's federal securities fraud claim without deciding their motion to compel arbitration of that claim.

On appeal, AFP sought review of the District Court's grant of summary judgment (and other orders not pertinent here). Petitioners chose not to argue, as an additional ground justifying the District Court's dismissal of AFP's section 10(b) claim, that it was arbitrable, even though this Court had already questioned in *Byrd* whether the long-standing federal policy against enforcing agreements to arbitrate section 10(b) claims should be re-examined. Petitioners confined their arguments on appeal to defending the District Court's grant of summary judgment.

It was only after the Second Circuit stated, in reversing summary judgment and remanding the section 10(b) claim to the District Court, that the arbitration clause was "of course, unenforceable," *AFP Imaging Corp.* v. *Xenon, supra* at 205, that petitioners sought to argue this issue in their petition for rehearing. The Second Circuit properly denied petitioners' petition for rehearing as to a claim they could have, but did not, present and argue in the first instance. *See Donovan* v. *Brandel,* 760 F.2d 126 (6th Cir. 1985);

*United States* v. *Klotz*, 503 F.2d 1056 (8th Cir. 1974); *Local No. 1505 Int'l Bro. of Elec. Workers* v. *Local Lodge No. 1836*, 304 F.2d 365, 368 (1st Cir. 1962); *Carr* v. *Federal Trade Comm'n*, 302 F.2d 688, 692 (1st Cir. 1962).

It would certainly be anomalous for petitioners to obtain review on *certiorari* of an issue they sought to present to the Court of Appeals only as an afterthought in a petition for rehearing which the Court of Appeals denied.

Further, because the parties did not have an opportunity to brief and develop this issue in the Second Circuit, this Court would have to determine the enforceability of pre-dispute agreements to arbitrate section 10(b) claims without the benefit of development and amplification of the arguments, or a reasoned opinion, in the court below. *See Kimbrough* v. *United States*, 364 U.S. 661 (1961) (writ of certiorari dismissed because the record did not present the question with sufficient clarity). After this Court commented on the applicability of *Wilko* to section 10(b) claims in *Byrd*, numerous district courts re-examined the issue. A future case in which the issue is fully developed on the record, argued and decided in a circuit court, would benefit this Court with a variety of views and a full development of the issues and arguments presented should this Court later desire to decide this question.

### 2. The Record Does Not Present Or Develop The Question Presented With Sufficient Clarity

The contract of sale, dated August 8, 1984, was entered into and the sale of stock completed before this Court decided *Dean Witter Reynolds, Inc.* v. *Byrd*, *supra*. Prior to

*Byrd*, the law was clear in the Second Circuit, *e.g.*, *Greater Continental Corp.* v *.Schechter*, 402 F.2d 1100 (2d Cir. 1970), and in at least eight other circuits (see cases cited, *infra* at 9, n.4), that section 10(b) claims were not arbitrable. Indeed, even in *Byrd*, Dean Witter Reynolds, Inc. did not seek to compel arbitration of the section 10(b) claim asserted against it because it assumed that the arbitration clause in its contract was unenforceable as to a section 10(b) claim. *Dean Witter Reynolds, Inc.* v. *Byrd, supra*, at 1240, n.1.

Thus, at the time of the contract at issue and at the commencement of this action, AFP had relied on the established rule that federal securities fraud claims were not arbitrable. The arbitration clause in its contract of sale with petitioners was designed to redress the type of disputes that may arise from a good faith transaction—not an integrated scheme to defraud purchasers to buy grossly overvalued stock. Because of the settled status of the law at the time this action was commenced, AFP did not allege in its complaint that the arbitration clause was unenforceable and was part of petitioners' scheme to defraud by precluding respondent from exercising its right under section 27 of the 1934 Act to seek redress in a federal court. *See The Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972). In these circumstances, the issue of the arbitrability of section 10(b) claims is not presented to this Court with the factual development in the lower courts which a post-*Byrd* transaction might afford.

Further, this action was commenced, and summary judgment granted, before this Court decided *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, —— U.S. ——, 105

S.Ct. 3346 (1985). Thus, there was certainly no opportunity in this litigation for the parties or the lower courts to examine and develop evidence relevant to the factors which need to be considered in deciding arbitrability of a claim pursuant to this Court's decision in *Mitsubishi*. Therefore, this case is not an appropriate vehicle to review the established federal policy precluding arbitration of section 10(b) claims.

### B. There Is No Conflict In the Circuits As to the Federal Policy That Section 10(b) Claims Are Not Arbitrable

Petitioners have stated that the Second Circuit's decision in this case "is in direct conflict with holdings of other courts...." (Memorandum For The Petitioners at 19. See also pp. 8, 17-19). The "other courts" petitioners refer to are district courts, and many of those courts were district courts within the Second Circuit. Presumably, those courts will henceforth abide by the Court of Appeals' direction to "adhere to the settled law of this Circuit." *McMahon*, *supra*, slip op. at 2756.

Rule 17(a) of this Court provides that a writ of certiorari may be granted "[w]hen a federal court of appeals has rendered a decision in conflict with the decision of another federal court of appeals on the same matter." The decision of the Court of Appeals in this case is not in conflict with a decision of the Court of Appeals of any other circuit and, as this Court has recognized, the Second Circuit's rule has retained "considerable vitality" in the other Courts of Appeals.[4] *Dean Witter Reynolds, Inc* v. *Byrd*, —— U.S. at ——, 105 S.Ct. at 1240, n.1 (1985).

4. At least nine circuit courts, the Second, Third, Fifth, Sixth Seventh, Eight, Ninth, Tenth, and Eleventh Circuits, have held that

*(footnote continued on next page)*

Since *Dean Witter Reynolds, Inc.* v. *Byrd, supra,* the decisions of various district courts may be in conflict with their circuits' precedents or with other district courts. *Compare, Moncrieff* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 623 F. Supp. 1005 (E.D. Mich. 1985) (rejecting prior Sixth Circuit precedent that section 10(b) claims are not arbitrable) *with Bale* v. *Dean Witter Reynolds Inc.*, No. 85-1280, slip op. (D. Minn. Jan. 30, 1986) (following Eighth Circuit precedent that section 10(b) claims are not arbitrable). However, no conflict exists among the circuit courts as to the unenforceability of an arbitration clause as to a section 10(b) claim.[5] If a conflict should subse-

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*Wilko* applies to section 10(b) claims. *E.g., Greater Continental Corp.* v. *Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970); *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3rd Cir.), *cert. denied*, 429 U.S. 1010 (1976); *Sibley* v. *Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1039 (6th Cir. 1979); *Weissbuck* v. *Merrill Lynch, Pierce, Fenner & Smith*, 558 F.2d 831, 833-835 (7th Cir. 1977); *Surman* v. *Merrill Lynch, Pierce Fenner & Smith, Inc.*, 733 F.2d 59 (8th Cir. 1984); *DeLancie* v. *Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Moore*, 590 F.2d 823, 827-29 (10 th Cir. 1978); *Raiford* v. *Buslease, Inc.*, 745 F.2d 1419 (11th Cir. 1984). The Fourth, First and D.C. Circuits appear not to have ruled specifically on this question. *Land* v. *Dean Witter Reynolds, Inc.*, 617 F.Supp. 52 (E.D. Va. 1985); *see Singer* v. *Dean Witter Reynolds, Inc.*, 614 F.Supp 1141 (D. Mass. 1985); *cf. Ingbar* v. *Drexel Burnham Lambert, Inc.*, 683 F.2d 603, n.1 (1st Cir. 1982) (recognizing that *Wilko* has been extended by caselaw to 1934 Act claims). The Second Circuit is the only circuit to date that has reaffirmed its prior holding since *Dean Witter Reynolds, Inc.* v. *Byrd, supra. See McMahon* v. *Shearson/American Express, Inc.*, Dkt. Nos. 85-7844, 85-7846 (2d Cir. April 16, 1986); *AFP Imaging Corp.* v. *Ross*, 780 F.2d 202 (2d Cir. 1985). In *Shihadeh* v. *Dean Witter Reynolds, Inc.*, 766 F.2d 461 (11th Cir. 1985), the Eleventh Circuit remanded the order staying arbitration of claims under the 1934 Act for reconsideration by the district court in light of *Dean Witter Reynolds, Inc.* v. *Byrd, supra,* and prior Eleventh Circuit precedent in *Raiford* v. *Buslease, supra.*

5. Petitioners have stated that arguments have been held in cases that are *sub judice* in the Third and Ninth Circuits. (Memorandum For The Petitioners at 18, n.6).

quently materialize between the Second Circuit and another circuit, the issue will then be ripe for review should this Court decide to determine it. This Court would then have the benefit of the divergent views of the various courts of appeals after careful scrutiny of the issue on full records. This case does not present such an opportunity.

### C. The Opinion Below Is Not In Conflict With Any Decision of This Court

The opinion below is not in conflict with any decision of this Court. Contrary to petitioners' contention, it is wholly consistent with, and based upon, *Wilko* v. *Swan, supra; Dean Witter Reynolds, Inc.* v. *Byrd, supra; Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974); and *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, —— U.S. ——, 105 S.Ct. 3346 (1985).

In *Wilko* v. *Swan, supra*, this Court held that an arbitration clause in a pre-dispute contract was not enforceable as to a claim under section 12(2) of the 1933 Act. This Court found that such an agreement was a "stipulation" binding the plaintiff to "waive compliance" with a "provision" of the 1933 Act, section 22(a), in contravention of section 14 of the Act. Section 22(a) of the 1933 Act provides the claimant a right to select a judicial forum, with all of the attendant rights. Section 14 voids an agreement waiving that right. The Court held that the provisions of the United States Arbitration Act, 9 U.S..C § 1 *et seq.*, were not controlling in view of the non-waiver provisions of section 14. *Id.* Like the 1933 Act, the 1934 Act provides the right to a judicial forum, section 27, and contains a non-waiver provision, section 29(a), nearly identical to section 14 of the 1933 Act.

Numerous lower courts have similarly interpreted the provisions of the 1934 Act and have extended the reasoning of *Wilko* to 1934 Act claims. In *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974), this Court noted that a colorable argument could be made that *Wilko* does not apply to section 10(b) claims because, unlike section 12 of the 1933 Act, in which a private right of action is expressly granted, the right of action under section 10(b) is implied. *Scherk* also noted another distinction between the 1934 and 1933 Acts: section 22 of the 1933 Act provides for state or federal jurisdiction while section 27 of the 1934 Act provides for exclusive federal jurisdiction. *Scherk* v. *Alberto-Culver Co., supra,* at 513.[6]

However, in *Scherk,* this Court accepted "the premise . . . that the operative portions of the language of the 1933 Act relied upon in *Wilko* are contained in the Securities Exchange Act of 1934." *Id.* at 515. The arbitration clause in that case was enforced as to a section 10(b) claim only because the transaction involved an international agreement. This Court found that in the context of international agreements "[a] contractual provision specifying in advance the forum in which disputes shall be litigated. . . is . . . an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction." *Id.* at 516. This Court reasoned that unless the arbitration clause in an international contract were enforceable it would "damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements." *Id.* at 517. The instant case involves a

6. These distinctions between the 1934 Act and the 1933 Act should not limit the applicability of *Wilko* to section 10(b) claims. (See *infra* at 14-17.)

wholly domestic transaction and none of those special considerations of international trade and comity are present here.

In *Byrd,* this Court noted that it had questioned the applicability of *Wilko* to section 10(b) claims in *Scherk* but did not hold that *Wilko* did not apply. *Byrd* rejected the "intertwining doctrine," a rule adopted in many of the lower federal courts, which had precluded arbitration of pendent state law claims which were "intertwined" with non-arbitrable federal securities law claims. In rejecting the intertwining doctrine, this Court expressly declined to rule on whether *Wilko* applied to section 10(b) and Rule 10b-5 claims, but commented in a footnote that:

> In *Wilko* v. *Swan,* 346 U.S. 427 (1963), this Court held that a predispute agreement to arbitrate claims that arise under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), was not enforceable. . . . Years later, in *Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506 (1974), this Court questioned the applicability of *Wilko* to a claim arising under § 10(b) . . . or Rule 10b-5. . . . The Court did not, however, hold that *Wilko* would not apply in the context of a § 10(b) or Rule 10b-5 claim, and *Wilko* has retained considerable vitality in the lower federal courts. Indeed, numerous District Courts and Courts of Appeals have held that the *Wilko* analysis applied to claims arising under § 10(b) . . . and that agreements to arbitrate such claims are therefore unenforceable.

*Id.* at ——, n.1, 105 S.Ct. at 1240, n.1.

Thus, *Byrd* expressly recognized the law prevailing in the lower federal courts and did nothing to alter it.[7]

7. The Second Circuit was aware of *Dean Witter Reynolds, Inc.* v. *Byrd* when it decided this case and noted that this Court considered the question open. *AFP Imaging Corp.* v. *Ross,* 780 F.2d *supra* at 205.

Finally, the opinion below is not in conflict with this Court's recent pronouncements concerning the United States Arbitration Act in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, —— U.S. ——, 105 S.Ct. 3346 (1985). *Mitsubishi*, like *Scherk*, concerned an international agreement. Moreover, *Mitsubishi* involved an agreement to arbitrate a claim under the Sherman Act, 15 U.S.C. § 1, *et seq.*, not the 1934 Act. The Sherman Act, unlike the 1933 and 1934 Acts, does not contain a "nonwaiver" provision which, *Wilko* held, could not be disregarded by a court in favor of a pre-dispute agreement to arbitrate.

### D. The Decision Below Is Correct

Petitioners contend that *Wilko* should not apply to 1934 Act claims because of certain distinctions between the 1933 and 1934 Acts: (1) section 12(2) of the 1933 Act provides an express right of action while the right of action under section 10(b) is implied; and (2) jurisdiction under section 22 of the 1933 Act extends to any state or federal court while jurisdiction of suits under the 1934 Act is limited by section 27 to the federal courts. (Memorandum for the Petitioners at 10-14). Petitioners also contend that *Wilko* should not apply to an arbitration clause negotiated between the parties in an arm's-length agreement. None of their arguments warrant reversal of long standing federal policy adhered to in at least nine federal circuits.

#### 1. The Distinction Between Implied and Express Rights of Action Should Not Limit the Applicability of *Wilko* v. *Swan*

*Wilko* did not hold that a pre-dispute agreement to arbitrate 1933 Act claims was unenforceable because section 12(2) of 1933 Act created an express right of action.

Rather, the arbitration agreement was held unenforceable because it waived the right to sue in a federal or state court which was guaranteed to an investor by section 22. *Wilko* v. *Swan, supra* at 436. It was the statutory right of a purchaser to judicial trial and review of a claim under the 1933 Act, *i.e.*, section 22, that this Court held could not be waived.

Applying the rationale of *Wilko* to the 1934 Act, it is not the implied right of action under section 10(b) that is impermissibly waived by a pre-dispute agreement to arbitrate, but the right, expressly granted by section 27, to trial of 1934 Act claims in a district court and to appellate review. Section 27 of the 1934 Act expressly applies to any action in equity or at law to enforce a duty under the 1934 Act. An action under section 10(b) is clearly one to enforce a duty under the 1934 Act since it has no other source but the 1934 Act. It is of no moment that the right of action is implied for it exists just as if it were expressly provided, and its existence is "simply beyond preadventure." *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 380 (1986). Thus, by its terms, section 27 applies to an action under section 10(b).

A right of action is implied only when it is found that Congress intended to create such an action. *Touche Ross* v. *Redington*, 442 U.S. 560 (1979). The right to sue to enforce the duties created by section 10(b) of the 1934 Act is no less part of statute for being implied than its express provisions—it exists solely because Congress intended it. The "question whether a statute creates a private right of action is ultimately one of congressional intent, not one of whether this Court thinks it can improve upon the statutory scheme

that Congress enacted into law." *Universities Research Ass'n* v. *Coutu*, 450 U.S. 754, 770 (1981), *quoting*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979). *See also Transamerica Mortgage Advisors Inc.* v. *Lewis*, 444 U.S. 11 (1979). "The federal judiciary will not engraft a remedy on a statute, no matter how salutary, that Congress did not intend to provide." *California* v. *Sierra Club*, 451 U.S. 287 297 (1981). *See also Daily Income Fund, Inc.* v. *Fox*, 464 U.S. 523 (1984); *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353 (1982); *Middlesex City Sewerage Auth.* v. *Nat'l Sea Clammers Ass'n.*, 453 U.S. 1 (1981).

Moreover, when Congress amended the 1934 Act in 1975 it recognized that private claims under section 10(b) had been implied by the courts. *See Herman & MacLean* v. *Huddleston, supra* at 384-86. When it did so, Congress was expressly aware that *Wilko* had been held by numerous courts to preclude arbitration of 1934 Act claims, yet it did nothing to alter those decisions. *See* H.R. Conf. Rep. No. 94-229, 94th Cong., 1st Sess. 91 (1975), U.S. Code Cong. & Admin. News, 1975, p. 342.

That the right of action under the 1933 Act in *Wilko* was expressly granted and the right of action under section 10(b) is implied is a distinction without a difference. It is the right to a judicial forum that is protected by section 29(a) of the 1934 Act and cannot be waived. There is no basis for removing from a section 10(b) claimant the protection guaranteed under section 29(a) without contradicting the clear intention of Congress.

### 2. The Difference Between the Jurisdictional Provisions of the 1933 and 1934 Acts Is Not Relevant to Whether 1934 Act Claims Are Arbitrable

In *Wilko*, this Court was concerned with the non-waivability, in advance of a dispute, of the federal judicial forum, not the choice between a state and federal forum, even though the choice between the state and federal forum was available to a plaintiff under the 1933 Act after a dispute had arisen. The issue in *Wilko* was whether section 22 and its grant of broad venue, nationwide service of process and judicial review could be waived by the parties, in advance of a dispute between them, by an agreement providing for a nonjudicial forum. Section 27 of the 1934 Act provides exclusive federal jurisdiction, not the choice between federal and state provided in section 22. This difference, far from evincing a Congressional intent that section 10(b) claims be arbitrable, shows the special solicitude of Congress for claims under that statute. If anything, it is all the more reason pre-dispute agreements to arbitrate 1934 Act claims should not be enforceable; Congress plainly intended that claims under the 1934 Act be resolved in federal courts, not state courts, and certainly not in a non-judicial forum.

### 3. Petitioners' Argument That the Rights and Remedies Provided to Defrauded Purchasers Under the 1934 Act Are Waivable in an Allegedly Fraudulent Arm's Length Agreement Is Without Merit

Petitioners argue that the long-standing federal policy against enforcement of agreements to arbitrate section 10(b) claims should not apply to agreements negotiated at arm's length. The argument has no basis.

In *Scherk* v. *Alberto-Culver, supra,* this Court did not rely on any distinction between an arm's length agreement, which *Scherk* involved, and other types of transactions in holding that arbitration agreements are enforceable in the context of international transactions. *Scherk* v. *Alberto-Culver, supra* at 512, n.6. Indeed, no court has relied on such a distinction to deprive a plaintiff of the right to seek redress of a section 10(b) violation in a federal court. *E.g., Greater Continental Corp.* v. *Schechter,* 422 F.2d 1100 (2d Cir. 1970). It was the international character of the transaction in *Scherk* that led this Court to withhold application of *Wilko* to the federal securities fraud claim not the nature of the transaction. *Scherk* v. *Alberto-Culver, supra,* at 515-19. Justice Douglas in his dissent in *Scherk,* while noting that the majority did not consider the bargaining strength of the parties in distinguishing *Wilko, id.* at 528, stated that:

> It could perhaps be argued that *Wilko* does not govern because it involved a little customer pitted against a big brokerage house, while we deal here with sophisticated buyers and sellers. . . . But that would miss the point of the problem. The Act does not speak in terms of "sophisticated" as opposed to "unsophisticated" people dealing in securities. The rules when the giants play are the same as when the pygmies enter the market.

*Id.* at 525-26.

To require enforcement of arbitration clauses when "sophisticated" purchasers of securities sue under the 1934 Act, while allowing "unsophisticated" purchasers the full benefit of the exclusive federal district court jurisdiction provided in section 27, would be an impermissible act of

judicial legislation. Congress alone should make such a nice distinction and it has not.[8] Indeed, it will be respondent's contention at trial that the arbitration clause in this contract was only one of a number of contractual provisions inserted by petitioners in an effort to deprive AFP of its lawful remedies for petitioners' fraud. Other provisions of the contract purport to limit AFP's recovery for any misrepresentations to the amount of a modest ascrow fund. Further, by using Xenon as the nominal contracting party in the agreement by which it was to be sold to AFP, petitioners sought to insulate themselves from liability for their misrepresentations. Together with those provisions the arbitration clause was an integral part of a scheme designed to evade the securities laws, a result section 29(a) of the 1934 Act is intended to prohibit. Where sellers induce a purchaser to buy their shares through fraudulent representations in the contract of sale and, in the same contract, seek to insulate themselves from liability through an arbitration clause and limitations on the amount the purchaser may recover, the agreement is hardly an "arm's length" transaction in which it would be just or consistent with the law to deprive him of the rights guaranteed by section 29(a) of the 1934 Act.

## Conclusion

This Court should deny the Petition for a Writ of Certiorari. This is not an appropriate case to review the

8. Petitioners' argument that a determination that section 10(b) claims are arbitrable would relieve federal court dockets (Memorandum For The Petitioners at 19-20) must be rejected. Even assuming that the contention has merit, it is no basis for allowing arbitration in contravention of the non-waiver provisions of section 29(a).

question presented: Petitioners chose not to argue their contention that the arbitration clause is enforceable as to the section 10(b) claim in the court below and the contract of sale was entered into, and this action commenced, before this Court's *dictum* in *Byrd* questioning the applicability of *Wilko* to section 10(b) claims. Should this Court ever wish to review this question, an opinion below where the issue is argued, briefed and decided in the Court of Appeals would be more appropriate for review. Further, no conflict exists amoung the Courts of Appeals as to the unenforceability of an arbitration clause as to a section 10(b) claim or between the Second Circuit decision in this case and any decision of this Court. Moreover, the decision below was correct since the nonwaiver provision of section 29(a) of the 1934 Act does not allow arbitration of this claim and waiver of respondent's right under section 27 of the 1934 Act to a federal judicial forum.

Dated: June 2, 1986

Respectfully submitted,

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# APPENDIX

§ 77l Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

§ 77r Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules or regulations of the Commission shall be void.

§ 77v The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.